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RUEHBO/AMEMBASSY BOGOTA 3761
RUEHQT/AMEMBASSY QUITO 1833
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E.O. DECL:05/25/2016
TAGS: EFIN EPET EINV PGOV PREL BR BL
SUBJECT: BRAZIL - A/S SHANNON MEETING WITH FINANCE MINISTER
MANTEGA

REF: A) BRASILIA 1008

B) BRASILIA 0961
C) BRASILIA 0888 and previous

Classified by Charge d'Affaires Phillip T. Chicola, reasons 1.4 (b) and (d).

¶1. (C) Summary: In a wide-ranging May 22 meeting, recently-appointed Finance Minister Guido Mantega told A/S Shannon and the Charge that Brazil's economy was "sound" and in good shape to weather the current volatility on world financial markets. Mantega and his International Secretary, Luiz Pereira, credited Brazil's decreased vulnerability to continuing high trade and current account surpluses, which have enabled it to pay down external debt and accumulate substantial reserves. Mantega reaffirmed the GoB's commitment to sound fiscal policy and to meeting its 4.25% of GDP primary surplus target. He said the GoB understood the importance of further social security system reforms to bring under control the system's burgeoning deficit, but noted that Lula would not publicly address this politically-sensitive reform prior to the October presidential elections. Turning to regional issues, Mantega affirmed that Bolivian gas would keep flowing, that there would be a negotiated price increase and that Petrobras energetically would defend its commercial interests in all appropriate fora. Shannon emphasized the importance of Brazil's institution-building and regional integration efforts in light of the wave of populism in the region. End Summary.

¶2. (SBU) In a May 22 meeting, recently-appointed Finance Minister Guido Mantega told visiting WHA A/S Tom Shannon that the Brazilian economy is doing well, and that the GoB has its fiscal accounts under control and is committed to meeting the 4.25% of GDP primary surplus target. Revenues were up, primarily due to the strong profitability of certain economic

sectors (mining, banking, oil), rather than tax rate increases, the FinMin affirmed. Mantega boasted that the Lula administration has run bigger primary surpluses than its PSDB (opposition party) predecessor, a commitment that has helped the GoB reduce its net-debt-to-GDP ratio. (Comment: Mantega, who in his previous jobs criticized the Finance Ministry's fiscal orthodoxy, in particular its over-performance of the primary surplus target, delivered the fiscal talking points without irony. End Comment.) Contrasting the current situation with that when the Lula Administration took office, Mantega affirmed that no one questions the GoB's ability to service its debts. Indeed, the GoB had pre-paid its debt to the IMF and the Paris Club and had re-purchased its Brady Bonds.

Market Volatility

¶3. (SBU) Mantega told Shannon that the GoB's strong external accounts have reduced substantially its vulnerability to a financial crisis. In the waiting room prior to the meeting, International Secretary Pereira noted to Shannon that the uncertainty in international financial markets over the course of the Federal Reserve's future interest rate decisions drove the nearly 4% depreciation of the Real against the dollar on May ¶22. (Note: this was followed by an almost 5% depreciation on May 24 and then a sharp rebound on May 25.) Pereira stated that Brazil was well-prepared for a period of market volatility, with continuing strong trade and current account surpluses driving a marked improvement in the country's external position. Both the GoB and private sector have reduced external debt. The GoB, moreover, has built up a large stock of international reserves (US$63.5 billion as of May 12), which was now almost equal to its net external debt and well in excess of short term

debt. Pereira expected that the markets would find a new equilibrium once the Fed's intentions became clear.

Defending the Administration's Economic Record
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¶4. (SBU) While average economic growth under the Lula Administration has been between 3% and 3.5%, Mantega affirmed that Brazil's economy could grow as much as 5% this year. Growth was improved, moreover, over the 2% to 2.5% average of the previous decade. "Brazil is not China," he stated, and cannot grow at rates upwards of 7% because it already reaped the large productivity gains that come from industrialization and the move from a primarily agricultural to an industrialized economy in the 1960's and 1970's. Brazil is democratic, and the government cannot impose reforms, although the GoB patiently has been strengthening economic institutions, such as the independent regulatory agencies. During Lula's term, Mantega stated, industry had grown strongly and employment was up significantly, as were wages and per capita income. The food-processing industry in particular was creating substantial numbers of new jobs, primarily in small and medium-size cities.

¶5. (SBU) Turning to the reform agenda, Mantega catalogued a series of reforms the GoB has undertaken or hopes to undertake, without clarifying which he considered priorities. "I've never seen a government undertake so many reforms," he boasted. Mantega stated that the GoB understands there is a need to reform the social security system, which is running increasing deficits (septel), but it was not the time publicly to discuss the sensitive issue, given the October presidential elections. In addition, awaiting congressional action are bills to unify the state-level value added taxes (ICMS), a bill to cut red tape for small and micro-enterprises, and a new competition law. The GoB already has undertaken targeted measures to reduce taxes on certain sectors and would like to simplify the bureaucratic requirements for imports, Mantega stated. The GoB also plans labor union reform and other (unspecified) reforms that it could not publicize during an election year, according to Mantega. Pereira added the GoB has undertaken measures to reduce the cost of capital and plans to take additional such steps in the

future.

Trade and Regional Integration, Institution-building
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¶6. (SBU) Although still relatively small as a percentage of GDP, Brazilian trade is growing quickly as the country inserts itself into the global economy, Mantega stated. Exports have been very strong, driving current account surpluses that have kept the exchange rate at appreciated levels. The country needs to increase imports, Mantega affirmed. Pereira noted that the GoB has focused on facilitating infrastructure development to underpin regional integration, such as a new bridge on the border with Peru and the paving of a trans-Andean highway in that country that together would create physical links to Brazil. These efforts have included financing from the National Development Bank (BNDES -- over which Mantega used to preside). The GoB also aims to reduce the asymmetries among the large and small Mercosul members and would like to strengthen its institutions. As part of this effort, the Finance Ministry leads GoB participation in the Mercosul macroeconomic convergence dialogue, Pereira said. Shannon applauded the GoB's focus on institutional strengthening and regional integration, particularly given the role that weak institutions have played in facilitating the current wave of populism in the region.

Bolivia: Reality Comes Knocking

¶7. (C) Bolivian President Morales was starting to come up against reality and likely would walk back some of his wilder pronouncements, Mantega stated. Bolivian gas would keep flowing, Mantega affirmed, although he acknowledged that the price Brazil paid (currently US$3 per 1000 BTU) needed to increase to better track oil and gas prices on world markets. Betraying irritation, Mantega argued that Morales should have made use of the existing contractual mechanisms to pursue price negotiations, rather than sending in troops to occupy Petrobras facilities.

¶8. (C) Bolivia, Mantega argued, is much more reliant on Brazil than vice versa. Brazil will develop additional domestic gas sources capable of producing gas volumes equivalent to those it currently receives from Boliva, according to Mantega. Petrobras, moreover, is even less reliant on Bolivia, which accounts for only about two percent of its investments world-wide. The GoB also had agreed to put consideration of IDB debt forgiveness on hold for the time being, according to Mantega. At the political level, however, President Lula would not take a strident line, Mantega stated, but rather take the same tone a parent would take when firmly disciplining an errant child. Nevertheless, Petrobras, Mantega declared, would defend its commercial interests in all appropriate fora.

¶9. (C) Comment: Mantega clearly is still settling into the job and becoming familiar with the subject matter. He put on a credible show, however, and was careful to avoid stepping on the Central Bank's toes, referring only briefly to monetary policy and limiting his comment to noting that the current situation was "satisfactory." At times he was clearly enjoying himself, joking, i.e., "as my right arm is in a sling, the fact that I shake hands with my left hand doesn't mean I am a leftist." Most welcome was Mantega's acknowledgement of the need for reform to stanch the budgetary bleeding in Brazil's social security system. That effort needs to succeed, as the burgeoning social security deficit, combined with constitutional earmarks and growing obligatory expenditures, will leave the next administration with little ability to make critical investments.

¶10. (U) This cable was cleared by A/S Shannon.

CHICOLA